Supreme Court, U.S.
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No. 02-689

IN THE

Supreme Court of the United States

PETER SCHEIBER,

Petitioner,

v.

DOLBY LABORATORIES, INC., *et al.*,

Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

REPLY BRIEF

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REPLY BRIEF[1]

The principal question presented in the petition for certiorari asks this Court to reconsider *Brulotte v. Thys Co.*, 379 U.S. 29 (1964), which held *per se* unlawful a patent license agreement to the extent that it provided for the payment of royalties beyond the expiration of the patent. *Brulotte* – which incorrectly assumed that such agreements extend the life of a patent – has, in Judge Posner's words, "been severely, and as it seems to us, with all due respect, justly, criticized." Pet. App. 3a. Indeed, *Brulotte* is fundamentally misguided. A contract for payment of royalties beyond the term of the patent cannot extend the patent, because the patent grants solely the right to exclude others from making, using, and selling, and "[a]fter the patent expires, anyone can make the patented process or product without being guilty of patent infringement." *Id.* The extension of royalty payments is simply "a risk-shifting credit arrangement between patentee and licensee," *id.* at 4a (internal quotation marks omitted), that will typically benefit both parties and impose no harmful consequences. Such extensions should not be *per se* unlawful.

Dolby's Brief in Opposition all but ignores the Petition's forthright request that this Court overrule *Brulotte*. Dolby's initial observation, for example, that the decision below does not "conflict[] with any decision of this Court or of another court of appeals," Dolby Br. at 8, is irrelevant: there is no reason to expect disagreement among the Circuits when a decision of this Court is directly on point.

Instead, when the Court is asked to reexamine one of its decisions, the relevant questions are (1) whether the decision should be reexamined, and (2) whether the particular petition presents a proper vehicle for that reexamination. On those critical questions, Dolby has nothing to say. That silence speaks volumes. *Brulotte* has been subject to withering

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[1] By letter filed in this Court on November 18, 2002, after the Petition was filed, undersigned counsel became counsel of record in this case.

criticism not only in Judge Posner's opinion below but also in academic and professional commentary; it is at odds with fundamental principles of economic analysis and this Court's current jurisprudence; it forecloses socially beneficial licensing arrangements and thereby deters innovation; and it now serves principally as a trap for the unwary. It is a remnant of abandoned doctrine and should be overturned, and this case provides an ideal vehicle for doing so.

1. The Brief in Opposition cannot muster any serious defense of *Brulotte*, and devotes but one desultory paragraph to "The Merits of *Brulotte*." Dolby Br. at 12-13. That is doubtless because *Brulotte* is indefensible. The academic and professional literature uniformly condemns it. *See, e.g.*, 10 Areeda *et al.*, *Antitrust Law* ¶ 1782c2-c3, at 505-11 (1996) (describing in detail "the error in *Brulotte*"); I. Ayres & P. Klemperer, *Limiting Patentees' Market Power Without Reducing Innovation Incentives: The Perverse Benefits of Uncertainty and Non-Injunctive Remedies*, 97 Mich. L. Rev. 985, 1027 (1999) ("Our analysis thus suggests that *Brulotte* should be overruled."); 1 Hovenkamp, Janis & Lemley, *IP and Antitrust* §§ 23.2a-23.2b, at 23-5 to 23-18 (2002 & 2003 Supp.) (describing the Court's reasoning as "dubious" and noting that the Court's "concerns are misplaced") ("Hovenkamp"); American Bar Ass'n Section of Antitrust Law, *Intellectual Property Misuse: Licensing and Litigation* 137-38 (2000) (stating that "the current doctrine seems flawed" and that collecting post-expiration royalties is "at worst likely to be economically neutral and at best may be economically desirable").[2]

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[2] *See also* H. See & F. Caprio, *The Trouble with Brulotte: The Patent Royalty Term and Patent Monopoly Extension*, 1990 Utah L. Rev. 813, 851 (1990) (arguing that *Brulotte* "is wrongly decided") ("See & Caprio"); R. Dreyfus, *Dethroning Lear: License Estoppel and the Incentive to Innovate*, 72 Va. L. Rev. 677, 709-12 (1986) (noting that the "reasoning in *Brulotte*

Without mentioning – much less rebutting – this criticism, Dolby blithely contends that "[o]verruling *Brulotte* would enable patent holders to circumvent the constitutional mandate that patents have finite duration." Dolby Br. at 12. But that is just wrong. After the patent expires, "the exclusive right to make, use or sell the licensed invention also ends," See & Caprio, 1990 Utah L. Rev. at 814, and "competing manufacturers are free to employ the patented technology the instant the patents expired," 10 Areeda ¶ 1782c3, at 509. Nor is there any danger that patentees will seek to enhance profits by "leverag[ing] their legally temporary rights into a potentially indefinite stream of future royalties based on post-expiration use." Dolby Br. at 12. As *Brulotte* correctly observed, a "patent empowers the owner to extract royalties as high as he can negotiate with the leverage of that monopoly." 379 U.S. at 33; *see also* 10 Areeda ¶ 1782c3, at 507. A patentee, however, can extract no *additional* profits by extending the term of payments. *See* 10 Areeda ¶ 1782c3, at 507 ("[T]he patentee already charging his profit-maximizing price cannot enlarge profits simply by requiring at the outset that royalties be paid for a long period."); *cf. Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 36 (1984) (O'Connor, J., concurring) (it is "widely accepted" that the "existence of a tied product normally does not increase the profit that the seller with market power can extract from sales of the *tying* product"); R. Bork, *The Antitrust Paradox* 372-75 (1978).

The extension of royalties beyond the term of the patent is merely a "risk-shifting credit arrangement between patentee and licensee. The arrangement can be no more than that,

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is vulnerable on several counts"). Nor has this Court endorsed *Brulotte* in later decisions; Dolby cites *Aronson v. Quick Point Pencil Co.*, 440 U.S. 257 (1979), but in that case the Court simply distinguished *Brulotte* and concluded that the contract at issue was *enforceable*. *See id.* at 264-65; *cf.* Dolby Br. at 10.

because the patentee at that time has nothing else to sell." See & Caprio, 1990 Utah L. Rev. at 851; *see also* Amicus Brief of Memorial Sloan-Kettering Cancer Center *et al.* ("Amicus Br.") at 5-6. The extension allows the licensee to make smaller pre-expiration payments in return for making certain post-expiration payments. *See* Pet. App. 4a ("The duration of the patent fixes the limit of the patentee's power to extract royalties; it is a detail whether he extracts them at a higher rate over a shorter period of time or a lower rate over a longer period of time."); 1 Hovenkamp § 23.2, at 23-9 ("The patentee could as easily have charged a higher royalty rate but made the royalty requirement expire with the patents."); *see also* 10 Areeda ¶ 1782c3, at 509. The risk of patent abuse that concerned the *Brulotte* Court is thus a phantom.[3]

Against this backdrop, *Brulotte*'s *per se* rule is plainly flawed. Agreements that provide for reduced short-term payments in return for post-expiration royalties can encourage innovation, allowing parties to defer the agreed-to remuneration during the critical research and development stage and shift some of the financial risk of market development from licensee to licensor. Moreover, despite *Brulotte*'s concerns about leverage and tying, such agreements will rarely have anti-competitive effects. *See, e.g.*, 1 Hovenkamp § 23.2, at 23-11 ("there is no reason for thinking that such agreements injure competition in any way, except perhaps in a few circumstances discoverable under the rule of reason"); 10 Areeda ¶ 1782c3, at 507 (observing that the "conditions necessary for such an [anti-competitive] effect are undoubtedly rare"). Because the agreements condemned in *Brulotte* offer considerable potential to enhance consumer welfare and spur innovation, and because

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[3] Contrary to Dolby's suggestion, *see* Dolby Br. at 9, the leveraging analysis does not depend on whether the license covers a patented machine or a "patented idea." In either case, the value of pre-expiration rights determines the maximum the patentee can charge.

they lack "predictable and pernicious anticompetitive effect," *State Oil Co. v. Khan*, 522 U.S. 3, 10 (1997); *see also, e.g.*, Hovenkamp, *Federal Antitrust Policy* 404 (1999) ("The *per se rule* . . . is applied to certain practices after the court understands them sufficiently well to conclude that they are almost always harmful"), such agreements should not be subject to a rule of *per se* illegality. And overruling *Brulotte* would not make such agreements *per se* legal; rather, it would test their legality under a rule of reason.

Indeed, *Brulotte*'s *per se* rule is anachronistic given the Court's movement toward the rule of reason and away from *per se* rules in evaluating claims of harm to competition, *see, e.g.*, *Khan*, 522 U.S. at 7; *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36, 58-59 (1977), and is a particularly inapt way to address tying concerns. *See, e.g.*, *Jefferson Parish*, 466 U.S. at 35 (O'Connor, J., concurring).

As the abundant academic and professional criticism suggests, and as the amicus brief of Sloan-Kettering and other renowned research institutions makes clear, *see* Amicus Br. at 5-7, *Brulotte*'s misguided rule continues to impose real-world harm. With respect to drug research, for example, *Brulotte* inhibits research institutions from licensing their patents to the companies best situated to translate academic medical advances into viable commercial products. *See id.* The need to re-examine *Brulotte* thus extends well beyond this case.

That said, the potential for injustice in *this* case should not be ignored. As the allegations here vividly illustrate, *Brulotte* creates a trap for the unwary, permitting sophisticated repeat players who, like Dolby, are familiar with license agreements and the law that governs them to take advantage of inventors who, like Mr. Scheiber, may lack detailed knowledge of this Court's patent decisions. *Brulotte* should thus be reconsidered.

2. Mr. Scheiber's case provides an ideal vehicle for reconsidering *Brulotte*. Both the district court and the court of appeals relied solely on *Brulotte* to dispose of Mr. Scheiber's claims. *See* Pet. App. 3a (noting that *Brulotte* is "indistinguishable"); Pet. App. 26a (holding Mr. Scheiber's claims foreclosed by "federal patent law"). Although Dolby attempts to cloud matters by accusing Judge Posner and Mr. Scheiber of "factual misstatements," Dolby Br. at 3, the factual quibbles Dolby raises – over the genesis of the license agreement, whether Dolby agreed to post-expiration royalties as a *quid pro quo* for a lower royalty rate, and whether Mr. Scheiber was "unwary," *id.* at 13 – are irrelevant to the question whether *Brulotte* should be overruled (and are meritless in any event, *see* note 4, *infra*).

One matter raised by Dolby, however, deserves brief comment. Dolby suggests that "the License Agreement did not require post-expiration royalties." *Id.* at 6. But the Seventh Circuit squarely rejected that argument, Pet. App. 2a-3a, and rightly so. Indeed, Dolby itself made quarterly payments to Mr. Scheiber totaling approximately $180,000, based on United States sales, *after* the expiration of the United States patents. *See id.* at 22a. Tellingly, Dolby first raised this argument in a supplemental brief in the district court, several months after Dolby's initial briefs, which emphasized *Brulotte*. As the Seventh Circuit found, and the facts amply show, the License Agreement required post-expiration royalty payments.[4]

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[4] There is no legitimate dispute that the License Agreement provided for payments beyond the expiration of the last United States patent and that these post-expiration payments were a *quid pro quo* for reduced royalty payments that Dolby believed would be better accepted by its sublicensees. Section 3.1 of the Agreement makes that explicit: "[Dolby] has represented that market development will be inhibited if it increases its license rates . . . because of the addition of the Patent Rights. *Accordingly, during the term of the License Agreement*, [Dolby] shall pay" the agreed-upon royalties. License Agreement § 3.1 (emphasis added). *See generally* Pet. App. 3a. In

3. Dolby also asserts that overturning *Brulotte* is a matter for Congress, not this Court. But in similar circumstances this Court "has not hesitated to overrule an earlier decision and settle a matter of continuing concern, even though relief might have been obtained by legislation." *United States v. Reliable Transfer Co.*, 421 U.S. 397, 409 n.15 (1975).

As an initial matter, *Brulotte* is a judge-made rule, not an interpretation of federal patent statutes. The statute mentioned in *Brulotte* does not address royalties at all, let alone the propriety of post-patent-expiration royalties. *See* 35 U.S.C. § 154(a)(1). More generally, the "language of the Patent Act nowhere condemns" contracts providing for post-expiration royalties. 1 Hovenkamp § 23-2, at 23-11. As Judge Posner explained, *Brulotte* is not "based on the interpretation of . . . the patent statute or any other statute; but it seems rather to have been a free-floating product of a misplaced fear of monopoly." Pet. App. at 5a; *see also Brulotte*, 379 U.S. at 31-32; *USM Corp. v. SPS Techs., Inc.*, 694 F.2d 505, 510-12 (7th Cir. 1982).[5] Where the Court itself is responsible for the erroneous

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addition, the License Agreement provides that "[t]he term of this Agreement shall be from the effective date hereof until the date of expiration of the last to expire patent in the Licensed Patents." Pet. App. 25a. The phrase "Licensed Patents" is defined in the Agreement to include both the United States patents (the last of which expired on May 25, 1993) and the later expiring Canadian Patents (the last of which expired on September 5, 1995), *id.*; *see also id.* 21a-22a – thus plainly requiring payments beyond expiration of the United States patents.

This interpretation of the contract is also consistent with evidence presented by Mr. Scheiber. *See* Appellant Br. at 7-8, 16 n.6, 37. Although Dolby disputes that evidence, the dismissal of Mr. Scheiber's claims on summary judgment as *per se* unenforceable under *Brulotte* requires the Court to view all facts in the light most favorable to Mr. Scheiber.

[5] *Scott Paper Co. v. Marcalus Manufacturing Co.*, 326 U.S. 249 (1945), is not to the contrary. *Scott* merely stated generally that the consequences of patent expiration should be "derived from the patent laws *and the policies which they adopt*." *Id.* at 255 (emphasis added).

rule, the Court need not "place on the shoulders of Congress the burden of the Court's own error." *Monell v. Department of Soc. Servs.*, 436 U.S. 658, 695 (1978) (internal quotation marks omitted).

With respect to other judge-made patent doctrines, this Court has overruled its own decisions when appropriate. The equitable patent misuse doctrine to which the *Brulotte* rule is closely related has its roots in *Motion Picture Patents Co. v. Universal Film Manufacturing Co.*, 243 U.S. 502, 518 (1917), which itself overruled *Henry v. A.B. Dick Co.*, 224 U.S. 1 (1912). Likewise, in *Lear, Inc. v. Adkins*, 395 U.S. 653 (1969), this Court overruled *Automatic Radio Manufacturing Co. v. Hazeltine Research Inc.*, 339 U.S. 827 (1950), and thereby did away with a doctrine of patent licensee estoppel originated by this Court in the nineteenth century. *See Lear*, 395 U.S. at 656, 663-64. And in *Blonder-Tongue Laboratories v. University of Illinois Foundation*, 402 U.S. 313 (1971), the Court overruled *Triplett v. Lowell*, 297 U.S. 638 (1936), which had espoused a "judge-made doctrine" that permitted a patent owner to bring new claims for infringement even after the patent had been found invalid in an earlier suit involving a different party. *See Blonder-Tongue*, 402 U.S. at 320, 330, 334, 350.

In the related area of antitrust – which addresses the concerns about leverage and abuse of monopoly power that weighed heavily in *Brulotte* – the Court has similarly not hesitated to overturn decisions, notwithstanding congressional inaction, when "the theoretical underpinnings of those decisions are called into serious question." *Khan*, 522 U.S. at 4; *see also, e.g.*, *GTE Sylvania*, 433 U.S. at 47-48, 57-59 (overturning *per se* rule for restrictions on retailers). Reconsideration of this Court's precedent is as appropriate here

as it was in cases such as *Khan*, *Blonder-Tongue*, and *Lear*.[6]

Dolby also suggests that Congress's consideration and enactment of the Patent Misuse Reform Act, Pub. L. No. 100-703, 102 Stat. 4674, 4676 (1988), somehow ratified *Brulotte*. But this Court has warned repeatedly against "the danger of placing undue reliance on the concept of congressional 'ratification.'" *Patterson v. McLean Credit Union*, 491 U.S. 164, 175 n.1 (1989).[7] That warning is particularly apt here, because the statute Congress adopted – 35 U.S.C. § 271(d)(5) – is utterly inconsistent with the policy and reasoning that underlie *Brulotte*. Section 271(d)(5) *removes* from the realm of *per se* illegality efforts by a patent holder to tie a license for patent rights to the sale of a separate product or license of a separate patent. Congress's relaxation of restrictions on the very tying arrangements that so troubled the *Brulotte* Court cannot be construed as a ratification of the rule in *Brulotte*; to the contrary, that legislation further undermines *Brulotte*, and confirms its status as a "remnant of abandoned doctrine." *Planned Parenthood of Southeastern Pa. v. Casey*, 505 U.S. 833, 854-55 (1992) (plurality op.); *see generally Patterson*, 491 U.S. at 173-74; *see also* Pet. at 17-18 (quoting Rep. Kastenmeier regarding "linkage between the patent licensing practice and anticompetitive conduct"); 1 Hovenkamp § 23.2, at 23-10 ("[I]t seems quite anomalous to require market power,

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[6] Although this Court has on occasion expressed concerns about changing rules that affect property rights or settled expectations, such concerns are at a minimum here. Lifting *Brulotte*'s *per se* ban will disturb only those parties that entered a license agreement inconsistent with *Brulotte* in the hope that the agreement would later be declared unenforceable.

[7] *See also, e.g.*, *Blonder-Tongue*, 402 U.S. at 327 n.17, 339-42 (refusing to find ratification despite "the introduction of several bills" to effect relevant changes, congressional hearings on the *Triplett* issue, and an intervening reform of the patent statute); *Reliable Transfer*, 421 U.S. at 409 n.15 (citing *Burnet v. Coronado Oil & Gas Co.*, 285 U.S. 393, 406 n.1 (1932) (Brandeis, J., dissenting) (collecting cases)).

if a separate product is shown, but not to require it if a separate product is not shown.").[8]

Finally, *Square D Co. v. Niagra Frontier Tariff Bureau, Inc.*, 476 U.S. 409 (1986), does not support Dolby here. *Cf.* Dolby Br. at 12. *Square D* was primarily an implied repeal case, in which the Court rejected the argument that the Reed-Bulwinkle Act, which created an immunity from antitrust laws for certain collective ratemaking activity, overturned case law granting a similar immunity for other tariff-related claims. *See* 476 U.S. at 418 (rejecting petitioners' argument that the Reed-Bulwinkle Act had "repudiated *Keogh*'s holding"). In addition, the precedent that petitioners in *Square D* sought to have overturned was expressly based on the interpretation of a statute, not a judge-made doctrine. *See id.* at 415-16, 420, 422 (describing *Keogh* as a case involving "statutory construction"). *Square D* thus has no relevance to the case at hand.

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The licensing of intellectual property "should be consistent with the state of the law and economic learning." *Competition and Intellectual Property Policy: The Way Ahead* (Nov. 15, 2001) (Remarks of FTC Chairman Timothy J. Muris to ABA Antitrust Section Fall Forum). *Brulotte* is consistent with neither, and it must be overturned to prevent continued infliction of its socially harmful consequences.

CONCLUSION

The petition for a writ of certiorari should be granted.

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[8]Nor is it relevant that Congress has on occasion extended the term of certain patents, *cf.* Dolby Br. at 12 & n.8; such targeted revisions can hardly be taken as a ratification of this Court's entire body of patent law.

Respectfully submitted,

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